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Ranchers using creative financing for Escalante mine purchase

By Gary Dillard
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Would a mining company like to finance a major project with money borrowed at 4 percent interest?

Ranchers Exploration & Development Corporation has found a way to do just that at its Escalante silver mine in Utah.

Ranchers has been mining silver at Escalante for two years and received stockholder permission in November to purchase the mine from its owner for stock.

In fiscal 1983, which ended June 30th, Ranchers reduced its annual interst payments at Escalante by about 65 percent by capitalizing on the singular circumstances surrounding the holding of precious metals, the company said in its annual report.

Holders of precious metals often seek a hedge against inflation. The value of their holdings increases with the inflationary rise in the cost of goods and services.

The metal holders pay a price for this inflation insurance. The metal, whether ingots, warehouse receipts or some other form, reposes in safekeeping without drawing interest.

There is no real rate of return above the rate of inflation. Refiners and others with metal inventories have the same problem.

About two years ago, Ranchers began to study whether these stores could be tapped in a way that would lower interest on loans obtained to finance Escalante.

Ranchers had borrowed $19.8 million for the project at prime rates that brought annual interest payments to about $2.5 million.

The idea that evolved was that silver might be borrowed at the historical real interest rates of two to three percent and then sold to raise funds that would be used to repay the bank loans bearing the prime rate of 15 percent or so. The silver would be repaid from production at Escalante.

When Ranchers originally borrowed the cash for Escalante development, it had only a rough idea for using low-interest silver borrowings, Herbert M. Campbell II, senior vice president, told PAY DIRT.

"It took up the better part of a year to complete the project," he said.

Ranchers didn't start pushing the metal borrowing vigorously until late summer and early fall 1982.

"Borrowing doesn't make sense unless you can sell the borrowed metal at more than the cash cost of production at the mine," Leland O. Erdahl, president, said in the annual report. "Until September, silver prices were barely above our cash cost of about $6 per ounce."

Once prices began to rise, Campbell and Marv Kaiser, another senior vice president and the treasurer, began to shuttle to and from New York City with increasing frequency, primarily to discuss lines of credit with the company's bankers.

Letters of credit based on these lines serve as collateral for the loans of silver, protecting the lenders in event of default on the loans.

FIRST SILVER LOAN

The first loan of silver — 300,000 ounces — was obtained in mid-November 1982 from a refinery. Only warehouse receipts were transferred. The interest rate was 2⅞ percent, computed on the daily fair market value of the silver.

Ranchers borrowed another 200,000 ounces in late November, 400,000 ounces in December and 700,000 ounces in January and February. Peak borrowing amounted to 1.6 million ounces.

Repayment began in March. Ranchers now is repaying at about 50,000 ounces a month from Escalante production. The mine produced about 2.26 million ounces in the last fiscal year.

"The entire borrowing has been executed without a hitch," Kaiser said in the annual report. "We reduced our interest expense to about $600,000 annually, and saved $1.75 million for the fiscal year, presuming our interest rate on the bank loan had remained at 15 percent.

"Where we were previously paying more than $1 in interest per ounce of production, we are now paying about 35 cents. This reduces our cash cost for producing an ounce of silver from about $6 to $5." Campbell said cash costs now are in the mid-$4 range.

Ranchers was the first to explore such long-term borrowing of silver, Campbell said. He added that "it's working just beautifully."

Borrowing has another advantage, as well. If the price of silver drops below the price at which the borrowed metal was sold, Ranchers can buy the lower-cost silver and repay the loan, earning a further discount.

At the September 30th quarter-end, Ranchers had about 1.3 million ounces of silver outstanding and about $13.1 million in liability for Escalante. (On the balance sheet, the debt is listed under liabilities as "proceeds from sale of future production."

REPAYMENT OF DEBT

With repayments of 50,000 ounces a month, Ranchers should have the silver repayed by fall 1985, but it may be done sooner, Campbell said. "The higher the price of silver is the more you can afford to devote to amortization of debt."

On the other hand, there's no gain in repaying the debt too soon. At less than 4 percent interest, including costs of arranging the loans, "that's very cheap money," Campbell said.

Whether any other companies will adopt Ranchers' method "relates to one's philosophy in marketing," he said. "A company that does not hedge" its future production would not use the method, he said. Hedging and borrowing of silver have to work together, he said. It's all "part of an insurance policy."

Can Ranchers lose? "You may give up a little bit on the up side, but it allows you to sleep better at night," Campbell said. If silver price rises over the term of the debt and Ranchers has hedged at a lower price, it won't be able to take advantage of the higher price.

Ranchers would be willing to use the method for developing other precious metal mines, he said. "It's an approach that has a lot of appeal for Ranchers," he added.

The method would not work for the Revenue-Virginius silver mine near Ouray, Colorado, he said, because that is being developed from cash flow instead of debt.

The bullion-borrowing method can be used only once a mine is in production, Campbell warned. "You have to be sure of your metal-producing capabilities" in order to pay off the borrowing.

On the other hand, a company with a silver mine such as Escalante that is paid for could use its production to repay bullion borrowed to pay off other debts. Ranchers could consider this, Campbell said.

At the end of its fiscal year, Ranchers had long-term debt of $25.6 million, up from only $771,000 a year earlier. That came in part for the acquisition of Kentucky-Tenness Clay Company and Colorado Aggregate Company.

Of Mines And Men

O'okiep Copper Company will reduce its South African labor force to 2,000 by mid-1984 and to 1,500 by 1984 year-end from 3,000 currently.

O'okiep, based in Nababeep, Cape Province, South Africa, is 49 percent owned by Newmont Mining Corporation.

The planned reductions in support staff and production force were attributed by the company to "depressed worldwide copper markets" which have led to significant losses.

For the nine months, O'okiep lost $3.8 million on revenue of $24.6 million. A year earlier, it lost $2.1 million.

Production at the Hoits and Spektakel mines will continue at current rates until developed reserves have been exhausted, the company said.

Mine production planned for the Carolusberg deep mine will be reduced in 1984, but will exceed 1983 levels.

At current metals prices and with the employee cutbacks, the company said its existing lines of credit will be exhausted in the 1984 first quarter. The company said it agreed in principle with lenders to increase credit lines and to reschedule payment of its borrowings outstanding.